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Message Text

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ACTION EB-07

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INFO USMISSION NATO
USMISSION OECD PARIS
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E.O. 11652: N/A
TAGS: ECON, EFIN, YO
SUBJECT: NATIONAL BANK GOVERNOR DISCUSSES DINAR CONVERTIBILITY
AND OTHER MONETARY ISSUES

SUMMARY: THE MAY 1 EDITION OF THE WEEKLY FEATURE MAGZAINE "NIN" CARRIED IN INTERVIEW WITH DR. BRANKO COLANOVIC, GOVERNOR OF THE NATIONAL BANK OF YUGOSLAVIA, IN WHICH HE DISCUSSED FURTHER STEPS TOWARD DINAR CONVERTIBILITY, SALES OF BONDS BY ENTERPRISES, INTEREST RATES CHARGED AND PAID BY THE BANKS, THE GROWTH OF THE MONEY SUPPLY, AND SELECTIVE CREDITS FO THE NATIONAL BANK. THE STEPS TOWARDS CONVERTIBILITY AND THE ENTERPRISE BOND SALES, WHEN ACCOMPLISHED, EVENTUALLY WOULD BOTH BE SHIFTS TOWARDS A WESTERN MARKET-ORIENTED ECONOMY. END SUMMARY.

1. COLANOVIC NOTED THAT PROGRESS HAS ALREADY BEEN MADE TOWARD CONVERTIBILITY OF THE DINAR, PARTICULARLY IN CIRCULATING THE DINAR ABROAD, LIBERAL DINAR AND FOREIGN EXCHANGE ACCOUNT POLICIES FOR FOREIGNERS AND YUGOSLAVS, AND IN TRADE AND BALANCE OF
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PAYMENTS RESULTS. HE THEN SUGGESTED FURTHER STEPS TOWARDS CONVERTIBILITY WHICH HE FEELS ARE NOW IN ORDER. GOODS AND SERVICES COULD BE INVOICED IN DINARS IN FOREIGN TRADE TRANSACTIONS AS IS NOW DONE IN CONVERTIBLE CURRENCY COUNTRIES. YUGOSLAVS SHOULD BE ABLE TO TRAVEL ABROAD WITH DINAR CHECKS ISSUED BY DOMESTIC BANKS AS WELL. COLANOVIC ADDED THAT "THIS OPERATION MUST BE THOROUGHLY PREPARED AND GRADUALLY INTRODUCED,

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BUT THERE IS NO REASON TO WAIT."

2. COLANOVIC DEFENDED THE 53 PERCENT INCREASE IN MONEY SUPPLY IN 1976, CITING LIQUIDITY SHORTAGES IN THE ECONOMY, A NEEDED ADJUSTMENT TO THE NEW ACCOUNTING AND PAYMENTS SYSTEM, AND THE FIRST HALF INDUSTRIAL STAGNATION. HE COMPARED THE MONETARY EXPANSION TO "A CONTROLLED NUCLEAR EXPLOSION" IN A REACTOR WHICH IS CAREFULLY MONITORED BY RESTRICTIONS ON INVESTMENTS, IMPORTS, PERSONAL INCOME, AND PUBLIC SPENDING. HE ACKNOWLEDGED PROBLEMS IN THE AREA OF PERSONAL INCOMES, BUT CLAIMED THAT ONLY IN THE AREA OF PUBLIC SPENDING HAD THE BARRIER "GIVEN AWAY COMPLETELY." SOCIAL ACCORDS WERE NOT EFFECTIVE IN PREVENTING THE SPENDING GROWTH BECAUSE THEY WERE ONLY RESOLUTIONS WITHOUT THE FORCE OF LAW. COLANOVIC ADDED THAT MANDATORY CONTROLS ON PUBLIC SPENDING ARE NOW BEING CONSIDERED WHICH WOULD STOP PAYMENTS TO THE ACCOUNTS OF PUBLIC SERVICES ONCE CERTAIN CELILINGS ARE REACHED.

3. REGARDING INTEREST RATES, COLANOVIC CRITICIZED THE 7.5 PERCENT INTEREST RATES NOW PAIDWN DEMAND DEPOSITS AS "A SHEER ABSURDITY", ESPECIALLY SINCE ELSEWHERE IN THE WORLD LITTLE IF ANYTHING WAS APID ON THEM. DIFFERENTIAL INTEREST RATES SHOULD BE INTRODUCED, BASED ON THE MINIMUM LENGTH OF TIME WHICH THE DEPOSIT WILL BE EHLD BY THE BANK. NO INTEREST SHOULD BE PAID ON DEMAND DEPOSITS OF COMMUNITIES OF INTERESTS AND SICIO-POLITICAL COMMUNITIES. TIME DEPOSITS OF CITIZENS SHOULD EARN 5 TO 6 PERCENT, INSTEAD OF THE CURRENT 9 PERCENT.

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4. WHILE THE ABOVE CHANGES WOULD CHEAPEN THE COST OF BORROWING TO ENTERPRISES, COLANOVIC ALSO URGED ENTERPRISES TO ISSUE BONDS THROUGH THE COMMERCIAL BANKING SYSTEM. THESE BONDS WOULD PAY A HIGHTER RATE OF INTEREST THAN SAVINGS ACCOUNTS AND WOULD ENABLE SAVERS TO PARTICIPATE DIRECTLY IN A PARTICULAR ENTERPRISE'S INVESTMENT PROGRAM.

5. COLANOVIC ALSO CALLED FOR THE RESPONSIBILITY FOR MOST FORMS OF SELECTIVE CRIDITS TO BE PASSED TO THE COMMERCIAL BANKS, AS THE PRINCIPAL FUNCTION OF THE NATIONAL BANK SHOULD BE TO REGULATE THE MONEY SUPPLY. ONLY CERTAIN FINANCING SHOULD BE KEPT IN THE PURVIEW OF THE NATIONAL BANK, INCLUDING AGRICULTURAL AND SHORT-TERM CREDITS. THE FINANCING OF RESERVES AND THE FEDERAL BUDGET SHOULD NOT BE DONE THROUGH THE PRIMARY EMISSION AS IS CURRENTLY THE CASE.

6. COMMENT: IT IS HIGHLY UNLIKELY THAT YUGOSLAVIA WOULD ATTEMPT FULL DINAR CONVERTIBILITY IN THE NEAR FUTURE, AS THE RISKS TO

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THE STABILITY OF THE ECONOMY ARE REAL AND THE BENEFITS ARE, TO
A LARGE EXTENT, INTANGIBLE. NEVERTHELESS, THE STEPS SUGGESTED
BY COLANOVIC ARE IMPORTANT ONES WHICH WOULD BRING CONVERTIBILITY
CLOSER TO REALITY--AT A COST. ALTHOUGH THE CURRENT CONVERSION
RATE OF THE DINAR IS DETERMINED BY A MATHMEMATICAL FORMULA BASED
ON THE DOLLAR AND THE GERMAN MARK, THE INTERNATIONAL FINANCIAU
COMMUNITY WOULD STILL BEAR CERTAIN EXCHANGE RISKS NOT NOW PRESENT
AND WOULD DISCOUNT THE DINAR ACCORDINGLY. AS COLANOVIC SAYS,
EVEN THESE STEPS MUST BE THOROUGHLY PREPARED AND GRADUALLY
INTRODUCED. THIS INTERVIEW IS ONLY THE GROUNDWORK FOR THEIR
EVENTUAL INTRODUCTION.

7. THE USE OF BONDS BY ENTERPRISES TO OBTAIN INVESTMENT FUNDS
WILL REQUIRE A CLEARLY DEFINED DEFAULT POLICY AND MORE
IMPORTANTLY, A DETERMINATION ON HOW THE ISSUANCE OF THESE
BONDS COULD BE RECONCILED WITH THE CONTROLS OVER INVESTMENT
AND ENTERPRISE BORROWING WHICH NOW EXIST AND WHICH THE
COMMERCIAL BANKS MUST CONTINUE TO HELP ADMINISTER. IT WOULD REMOVE
SOME OF THE PRESSURE NOW ON THE COMMERCIAL BANKING SYSTEM,
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WHICH IS CURRENTLY THE LENDER OF FIRST AND LAST RESORT.
IT WOULD ALSO BE ONE MORE STEP AWAY FROM THE TRADITIONAL MARXIST
ECONOMIC SYSTEM.

8. THE CRITICISM OF EXCESSIVE PUBLIC SPENDING BY COLANOVIC
IS A FAMILIAR THEME IN YUGOSLAVIA, ALONG WITH CRITICISM OF THE
INCREASED EMPLOYMENT AND INVESTMENT IN THAT SECTOR. THE REDUCED
PERCENTAGE OF SPENDING IN THE PRODUCTIVE SECTOR, ALTHOUGH
UNDERSTANDABLE AND EXPECTED IN A MODERN INDUSTRIALIZED ECONOMY,
SEEMS TO WORRY THE YUGOSLAVS GREATLY. THE LIMITATION ON PUBLIC
SPENDING SUGGESTED BY COLANOVIC IS UNDERSTANDABLE IN THIS
CONTEXT, BUT STILL UNREALISTIC. IN INABILITY OF THE RECENTLY-
REPEALED DEPOSIT REQUIREMENT ON INVESTMENTS IN THE NON-PRODUCTIVE
SECTOR TO REDUCE THESE INVESTMENTS IS A GOOD DEMONSTRATION OF
THE STRENGTH OF THIS TYPE OF SERVICE IN YUGOSLAVIA.

9. THE BANKING SYSTEM HAS BEEN CRITICIZED IN YUGOSLAVIA DURING
THE PAST FOUR MONTHS AND THE DEFENSIVE MANNER IN WHICH COLANOVIC
EXPLAINED THE 1976 INCREASE IN MONEY SUPPLY AND THE INTEREST
RATES CHARGED BY BANKS REFLECT THIS ATTITUDE. THE PRIMARY
COMPLAINT HAS BEEN THE SUPPOSEDLY HIGH PROFITS OF BANKS AND THE
PAST YEAR IN THE FACE OF INCREASED ENTERPRISE LOSSES. AS A
DIRECT RESULT OF THAT CRITICISM, VARIOUS BANKS HAVE PUBLICLY
REFUNDED PART OF THEIR 1976 PROFITS TO BORROWERS AND LOWERED
THEIR INTEREST RATES FOR LOANS. THE RECENT CRITICISM HAS FOCUSED
ON THE 57 PERCENT INCREASE IN MONEY SUPPLY IN 1976, WHICH
STRIKES DIRECTLY AT THE NATIONAL BANK AND COLANOVIC. HIS
COMPARISON OF THE ENCREASE OF THE MONEY SUPPLY TO A CONTROLLED
NUCLEAR EXPLOSION EMPHASIZES THE "CONTROLLED" ASPECT OF THE
EXPANSION, WHEREAS THE EMBASSY WOULD PLACE AT LEAST EQUAL
EMPHASIS ON "EXPLOSION". LIMITATIONS ON THE PERCENTAGE
OF RESERVE DEPOSIT REQUIREMENT WHICH THE NATIONAL BANK COULD
IMPOSE ON COMMERCIAL BANKS, REQUIRED AMOUNTS OF FINANCIAL
CREDITS FOR VARIOUS PURPOSES WHICH THE NATIONAL BANK WAS
OBLIGATED TO ISSUE. THE INFLOW OF HARD CURRENCY FROM ABROAD,
AND THE FIRST HALF INDUSTRIAL STAGNATION ALL REDUCED THE
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ABILITY AND WILL OF THE NATIONAL BANK TO HOLD THE INCREASE
TO THE LOWER LEVELS WHICH WERE PROJECTED.
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